Supreme Court, U.S.
FILED
MAY 12 1992
OFFICE OF THE CLERK

No. 91-1233

In the Supreme Court of the United States

OCTOBER TERM, 1991

CHARLES M. ZARZECKI, PETITIONER

v.

UNITED STATES OF AMERICA, RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF FOR THE PETITIONER

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1. A principal thrust of the government's effort to avoid this Court's review of the rule adopted by the court of appeals is to suggest that petitioner was subject to being validly convicted on other grounds, on which the court of appeals did not rely. That tack is untenable. When multiple theories of a single offense are submitted to a jury, a resulting conviction cannot stand if *any one* of those theories is *legally* unsound. *Griffin* v. *United States*, 112 S. Ct. 466, 474 (1991) ("[w]hen * * * jurors have been left the option of relying upon a legally inadequate theory, there is no reason to think that their own intelligence and expertise will save them from that error"); *Yates* v. *United States*, 354 U.S. 298, 312 (1957). Thus, as the Solicitor General himself advised this Court in *Griffin*: "[W]hen a judge incorrectly instructs the jury as to the law, and therefore creates a significant

risk that a jury might have convicted the defendant based on conduct that is not a crime, the defendant is entitled to a new trial." U.S. Br. 20, No. 90-6352.

In this case, the jury was allowed to convict petitioner if it believed that his *actual, arm's-length* trades were engaged in with the intent to affect the price of COMB stock, even if he had no fiduciary duty to anyone. The government defended that theory—and *only* that theory—in the court of appeals. See Appendix, *infra*. The court of appeals accepted it as its *sole* basis for affirming all of petitioner's convictions for securities fraud, wire fraud, and conspiracy. Pet. App. 12a-13a.[1] The government defends that holding in this court (*e.g.*, Br. in Opp. 11 & n.9, 14, 16-17), but, as we showed in the petition and further substantiate below, that holding cannot be reconciled with this Court's decisions.

The government's alternative theories on which the conviction could be upheld include its arguments that

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[1] We note, in this regard, that the government apparently hopes to save its wire fraud convictions even if this Court reverses the securities fraud convictions. Br. in Opp. 8 n.4. The court of appeals, however, affirmed the wire fraud convictions *solely* on the ground that petitioner committed securities fraud (Pet. App. 11a-13a), without a word of discussion of petitioner's related challenges to his wire fraud convictions (C.A. Br. 20-22; C.A. Reply Br. 6-10). Granting that there are *some cases* in which wire fraud convictions may stand while securities fraud convictions fall, as the government contends, this is not one of them. Rather, when the different types of fraud convictions are closely related, the Second Circuit will vacate mail or wire fraud convictions if the securities fraud convictions are invalid. See *United States* v. *Chestman*, 947 F.2d 551, 571 (2d Cir. 1991) (en banc), cert. denied, 60 U.S.L.W. 3735 (U.S. April 27, 1992) (No. 91-1085).

petitioner's trades were fictitious because he was "indemnified" by Drexel (Br. in Opp. 3, 7, 15, 16-17 n.13) and that petitioner did owe a fiduciary duty of some sort to COMB that he breached by not disclosing some unspecified fact (*id.* at 4-5, 7, 9, 15). Those theories—advanced in this Court although not relied on by the government in the court of appeals—are irrelevant because they were at best alternative bases for conviction offered to the jury at trial, theories that the jury may well have rejected on the facts while accepting the government's defective legal theory that actual trades made with "bad intent" are criminal without more.[2] All that is properly before

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[2] The government's recitation of the facts in this Court is at best a slanted one that assumes—incorrectly in light of the multiple theories submitted to the jury—that the jury must have resolved *all* factual disputes in the government's favor. For example, the government insists in this Court (although it did not argue below) that the use of the word "indemnified" in one of the taped conversations meant that Drexel would cover any losses that petitioner sustained by trading in COMB stock. In fact, in context, what the word meant was that petitioner—following Princeton Newport's longstanding trading strategy—would be allowed to buy sufficient convertible bonds at the public offering to cover his short position in COMB stock. Tr. 3758. In a transparent effort to manipulate the facts to fit its sinister interpretation of them, the government's statement completely ignores the fact that Princeton Newport *did* purchase bonds to cover its short position as soon as they became available in the public offering, as it always did. See Pet. 4-5, 6. The government likewise omits mention of the fact that petitioner's trading had *no effect* on the price of COMB stock. To describe petitioner's trades as "designed to give the false appearance that the COMB stock price was falling because of bona fide trading activity" (Br. in Opp. 9) is at best hyperbole, since the price of COMB stock was *not* falling and the government is assuming its legal conclusion in asserting that petitioner's trading activity was not bona fide.

this Court is the question decided by the court of appeals and raised in the petition. On that point, the government's defense of the court of appeals' holding is flatly wrong.

2. After a careful review of the cases and commentary on stock market manipulation, a commentator wrote in 1988 that "the law neither requires traders to disclose their motivations nor makes it illegal to trade for the purpose of changing prices." Thel, *Regulation of Manipulation Under Section 10(b): Securities Prices and the Text of the Securities Exchange Act of 1934*, 1988 COLUM. BUS. L. REV. 359, 420; see also Berle, *Liability for Stock Market Manipulation*, 31 COLUM. L. REV. 264, 272 (1931) (common law did not prohibit arranging trades for the purpose of influencing price). The government nevertheless comes to this Court and asks it to accept as established law the directly contrary propositions that "trades made to affect security prices violate Rule 10b-5" without more (Br. in Opp. 11), that "security trades constitute unlawful manipulation when made for the purpose of affecting market prices" without more (*id.* at 11 n.9), and that "[a] trade made to affect the market price or induce other trades is manipulative" without more (*id.* at 14). Supposedly in support of the latter proposition, the government cites the very article by Professor Thel that flatly *contradicts* its proposition. *Id.* at 14 n.10.[3] Something is very wrong here. What is wrong is the government's adamant refusal to recognize the necessary im-

[3] The government cites a page (1988 COLUM. BUS. REV. at 376) that does not support the proposition for which it is cited and that, in any event, reflects criticism of some of this Court's decisions rather than an assessment of what those decisions mean. The passage we have quoted, by contrast, is a black-letter statement of existing law.

pact of this Court's decisions, particularly *Schreiber* v. *Burlington Northern, Inc.*, 472 U.S. 1 (1985), on its theory of manipulation-by-intent.

It is a measure of the weakness of the government's position that it embraces with open arms the theory that it is crime to use a broker for the purpose of concealing the identity of the principal in a securities transaction. Br. in Opp. 9-10 (equating use of a broker with "use of dummies or fictitious parties"); *id.* at 4 (characterizing as a "subterfuge" petitioner's use of a broker, which the government concedes was the only basis for the "sleaze" comment). If that is a crime, then a great deal of trading activity that goes on in America is criminal. The government's theory is not limited to some narrow class of cases in which use of a broker violates some discernible *duty* to disclose the trader's identity, for petitioner—who was neither a fiduciary nor an insider—was under no duty (see *Chiarella* v. *United States*, 445 U.S. 222, 228-229 (1980)) to disclose *anything*.[4] In the absence of such

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[4] Thus, in the court of appeals, the government emphasized that it was *not* pursuing an insider trading theory (Gov't C.A. Br. 137) and adamantly defended the trial court's refusal to instruct the jury that it could find liability only if it found a breach of a fiduciary duty (*id.* at 135-138). The court of appeals likewise disclaimed any reliance on a "fiduciary relationship" in this case. Pet. App. 13a. In this Court, by contrast, the government has invented the entirely new theory that petitioner *did* have disclosure duties because he "was acting on behalf of and conspiring with Drexel." Br. in Opp. 12. But, of course, a conviction may not be affirmed on the basis of a theory not presented to the jury. *Chiarella*, 445 U.S. at 236. So that this Court can fully understand the degree to which the government has espoused in this Court theories that contradict its position in the court of appeals, we reprint as an appendix to this brief the *entire* discussion of securities fraud from the Argument section of the government's brief in the court of appeals.

a duty, it is perfectly legitimate for a trader who believes that his financial interest is furthered by nondisclosure of his identity to use a broker. See Thel, *supra*, 1988 COLUM. BUS. L. REV. at 405 ("the SEC * * * presumably * * * cannot require [traders] to reveal their identities").

Furthermore, the government has simply ignored the fact (see Pet. 21) that, had petitioner *not* used a broker and instead dealt with Jefferies directly, the only possible effect would have been to drive the price *lower*, thus furthering the alleged "scheme." The government asserts that "[d]eception of the public and COMB * * * was essential for petitioner's scheme to work" (Br. in Opp. 9-10), but it offers no clue as to how dealing with Jefferies directly (as petitioner *did* in one of the transactions on which his convictions rest) or telling *Jefferies* of Drexel's role would have resulted in greater disclosures to the public or COMB. The government's theory is illogical on the facts of this case. More important, the government's position has such far-reaching implications that it itself enhances the importance of review by this Court.

Equally telling is the government's response to our demonstration that, after *Chiarella* and *Schreiber*, "manipulation" cases require either a misrepresentation or a breach of a duty to disclose a specific fact. The government expressly denies "that the existence of a fiduciary duty is required to establish liability" (Br. in Opp. 12), but, like the court of appeals, never comes to grips with what we have shown (Pet. 11-14) to be the clear import of *Chiarella*, *Schreiber*, and the many commentaries reading those cases as we read them.[5] Rather, the government cites only two deci-

[5] The government attempts (at 10 & nn.7-8) to confine those cases to their facts, without even dealing with the

sions of courts of appeals, both decided *before* the pertinent decisions of this Court. One of those older decisions (*Charnay*) cannot survive this Court's subsequent rulings (see Pet. 16-17 & n.7), while the other does not support the government's position because it involved misrepresentations in the form of public purchases coupled with simultaneous secret sales at lower prices. *Crane Co.* v. *Westinghouse Air Brake Co.*, 419 F.2d 787, 792-798 (2d Cir. 1969), cert. denied, 400 U.S. 822 (1970).

Here, there were no undisclosed transactions to counterbalance the disclosed transactions and make their apparent import misleading. Rather, there were only public trades that the government admits would be legal (and not deceptive) if made with "good" intent but seeks to condemn (and label as "deceitful") because it regards them as having been made with "bad intent" (Br. in Opp. 16-17). Furthermore, petitioner cannot be swept within *Crane*'s misrepresentation theory because he was *acquitted* of making "untrue statement[s]" (17 C.F.R. § 240.10b-5(b)), a fact that the government acknowledges (Br. in Opp. 5) but then tries to dismiss in an incomprehensible passage (*id.* at 8) that accuses petitioner of the precise transgression of which he was acquitted. See *ibid.* (accusing petitioner of " 'false and fictitious acts' of manipulation" because he was convicted under the subsections of Rule 10b-5 that deal with fraudulent conduct *other than* expressing falsehoods and fictions); see also *id.* at 10-11 (accusing peti-

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broader principle of *Chiarella* that trading in silence (such as petitioner's) cannot be condemned as "deception" and the broader principle of *Schreiber* that "deception" is required before fraud by manipulation can be found.

tioner, based on trading alone, of "affirmative acts of deception" and "affirmative conduct designed to deceive investors by creating an artificial market price for COMB stock").[6]

Ultimately, the government's legal discussion is nothing more or less than a plea—with citations to pre-*Schreiber* cases, the legislative history of Section 9(a)(2) of the Securities Exchange Act of 1934,[7] and

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[6] The government's brief uses many pejorative labels. *E.g.*, Br. in Opp. I ("scheme to deceive an issuer and public investors"), 3 ("scheme to depress the price of COMB stock"), 4 ("device" and "subterfuge" consisting of selling through a broker), 7 ("scheme to manipulate the price of COMB's stock"), 10-11 ("conduct designed to deceive investors by creating an artificial market price"), 12 ("manipulative trading"), 16 n.12 ("self-help remedy for perceived illegal conduct by others"). What is consistently absent, however, is reasoning to justify the use of those labels. For example, the government describes petitioner's conduct as having "rigged prices." Br. in Opp. 9 & n.5 (emphasis omitted). As the name suggests, however, "rigged prices" are those that result from collusive activity between a buyer and a seller such that the true consideration paid for a stock differs from the price apparent to the public. Here, however, petitioner and Jefferies undeniably were trading at arm's length, with an actual exchange of consideration at the bargained price.

[7] The government is completely out of line when it contends in this Court (Br. in Opp. 14-15) that petitioner violated Section 9(a)(2), 15 U.S.C. § 78i(a)(2). It elected to charge this case under Section 10(b) and Rule 10b-5 *instead of* Section 9(a)(2), for the obvious reason that petitioner did *not* violate Section 9(a)(2) because he did not act "for the purpose of inducing the purchase or sale of such securities by others," as that section requires. See generally Pet. 22-24. The government also treats it as established law, although it cites only a single 16-year-old Ninth Circuit decision, that Section 10(b) is a broader prohibition of manipulative practices than Section 9(a)(2). Br. in Opp. 15. In fact, there is

commentators—to hold either that criminal "manipulation" under the securities laws does not require deception or that trading with "bad intent" can be shoehorned within the term "deception." This requires either a direct rejection of the unequivocal teaching of *Schreiber* that "manipulation" requires "deception," or a backdoor undermining of *Schreiber* by labeling mere trades as affirmative acts of deception based on nothing more than the intent of the trader. See Thel, *supra*, 1988 COLUM. BUS. L. REV. at 437 ("if the word deceptive is construed to include disruptive trading, it is being given a much broader construction than the Court, or for that matter almost anyone else, has given it"); see also *id.* at 428.

If the principle laid down so clearly in *Schreiber* is now to be overturned, however, that should be done only after full briefing and argument, and in any event not in a criminal case to which the rule of lenity applies. See generally *United States* v. *R.L.C.*, 112 S. Ct. 1329, 1338 & n.6 (1992) (plurality opinion); *id.* at 1339-1341 (Scalia, J., concurring in the judgment); *id.* at 1341-1342 (Thomas, J., concurring in the judgment). It would be unconscionable to deny certiorari and let a criminal conviction stand just because the government can make an argument suggesting—contrary to *Schreiber*—that "bad intent" provides all the deception necessary in a "manipulation" case based on actual trades.

All of the government's efforts to avoid the issue in this case—either by advancing arguments that were

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a split of authority on that question, with at least one court (see Pet. 22-23 n.12) holding that Section 10(b) is narrower than Section 9(a)(2) in manipulation cases and prohibits *only* that which Section 9(a)(2) prohibits.

not the basis of the holding below or by obfuscating about the meaning of this Court's decisions—should be rejected. This is a *criminal* securities fraud case in which liability cannot properly be premised on tenuous theories drawn from cases that are outdated (see Pet. 17 n.7) or easily distinguishable (see *id.* at 14-15 n.6, 17 n.7). While unfairly heaping opprobrium on petitioner throughout its brief in opposition, the government does not bother to deny (see Br. in Opp. 16-17 & n.13) that its theories would render many innocent activities criminal. See Pet. 25-29. This Court should not let that happen.

For the foregoing reasons and those given in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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MAY 1992

APPENDIX

APPENDIX

Excerpt from Brief for the United States of America, *United States* v. *Regan*, No. 89-1591 (2d Cir.)

[135] **D. The Jury Was Not Required To Find That Newburg And Zarzecki Breached a Duty Arising From A Relationship of Trust And Confidence.**

Newberg and Zarzecki contend that Judge Carter erred in refusing to instruct the jury that an omission is fraudulent under Rule 10b-5 only if the defendant breached a duty "toward a person with whom the defendant has a relationship which would cause that person to place trust and confidence in the defendant." (A. 911). In the defendants' view, they cannot be guilty of manipulation under Rule 10b-5 because they had no "general duty of disclosure." (Z/N Br. 16). In a similar vein, they also contend that their wire fraud convictions arising out of the COMB manipulation cannot stand because Judge Carter "failed to state that material non-disclosures are fraudulent only when there is a duty to disclose." (Z/N Br. 21). Neither claim has merit.

The first of those contentions evinces a profound misunderstanding of the governing law. Newberg and Zarzecki were prosecuted under Rule 10b-5 on a theory of manipulation. The term " 'refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity.' " *Schreiber* v. *Burlington Northern*, [136] *Inc.*, 472 U.S. 1, 6 (1985) (quoting *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 476-77 (1977)). *See also Ernst &*

Ernst v. *Hochfelder*, 425 U.S. 185, 199 (1976) (manipulation "connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities"); *Field* v. *Trump*, 850 F.2d 938, 946-47 (2d Cir.), *cert. denied*, 109 S. Ct. 1122 (1988).

It is well settled that persons who engage in such artificial and misleading practices commit a fraud on the public just as surely as if they affirmatively disseminated false statements in the market place. *See, e.g.*, *Schreiber* v. *Burlington Northern, Inc.*, *supra*, 472 U.S. at 7 n.4 (noting that deception can be effected not only with "false rumours" but also with "false and fictitious acts"); *In the Matter of Pagel, Inc.*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,909, at 87,752 (1985), *aff'd sub nom. Pagel, Inc.* v. *Securities and Exchange Comm'n*, 803 F.2d 842 (8th Cir. 1986). Not surprisingly, it has long been the law that such manipulative practices *themselves* give rise to liability, absent disclosure of the manipulation to the entire market. *See, e.g.*, *Thornton* v. *Securities and Exchange Comm'n*, 171 F.2d 702, 703 (2d Cir. 1948) (*per curiam*) (finding that defendant engaged in matched orders and wash sales "leads of course to the affirmance of the Commission's further findings that [defendant] willfully violated §§ 10(b) and 15(c) . . . in selling these stocks . . . at prices based on the exchange quotations without disclosure of its manipulation of the exchange market"); *United States* v. *Charnay*, 537 F.2d 341, 351 (9th Cir.) ("Failure to disclose that market prices are being artificially depressed operates as a deceit on the market place and is an omission of a material fact"), *cert. denied*, 429 U.S. 1000 (1976); 3 L. Loss, *Securities Regulation* 1561 (2d ed. 1961)

("when securities are in fact sold at manipulated prices without disclosure of the manipulation, it has been repeatedly held both by the Commission and by the courts that there is a violation of the anti- [137] fraud provisions"). Because the defendants were charged with manipulation, Judge Carter correctly refused to give the "fiduciary duty" instruction they requested.

Chiarella v. *United States*, 445 U.S. 222 (1980), on which the defendants rely, did not require Judge Carter to give a "fiduciary duty" instruction in this case. The fiduciary concept announced in *Chiarella* and its progeny, *see, e.g., Dirks* v. *Securities and Exchange Comm'n*, 463 U.S. 646 (1983), is relevant to cases where the defendant is accused of trading on the basis of material nonpublic information, and has no applicability where, as here, the gravamen of the charge is market manipulation. Because there was no evidence at all in this case concerning allegations of insider trading, no instruction on fiduciary duties was required. *See, e.g., United States* v. *Durrani*, 835 F.2d 410, 419-20 (2d Cir. 1987) ("A judge is required to charge on a defense theory only if the evidence provides some foundation for it").

The defendants' reliance on *Schreiber* v. *Burlington Northern, Inc., supra*, is even less apt. While they correctly note *Schreiber*'s holding that there can be no manipulation when all the relevant facts are disclosed, *Schreiber* v. *Burlington Northern, Inc., supra*, 472 U.S. at 7-8, this holding cannot possibly help them because they admit, as they must, that they disclosed nothing. In any event, defendants fail to explain how *Schreiber* can reasonably be read as compelling an instruction on an insider trading theory that was not

pressed by the Government or otherwise supported by any evidence.

The defendants' second claim—that Judge Carter erred in not charging that a wire fraud conviction may be grounded on an omission only if there is a duty to disclose—fares no better. Defendants' failure to request that "duty to disclose" charge (A. 896-904) "defeats their claim on appeal that such an instruction was required" absent plain error, which they wisely do not claim. *United States* v. *Keplinger*, 776 F.2d 678, 698 n.9 (7th Cir. 1985) (in mail fraud case, failure to request instruc- [138] tion requiring the jury to find a special relationship before it can find a duty to disclose is a waiver), *cert. denied*, 476 U.S. 1183 (1986). Furthermore, that claim was independently waived by the defendants' failure to object to the charge on that specific ground before the jury retired to consider its verdict. *See* Fed. R. Crim. P. 30; *United States* v. *Civelli*, *supra*, 833 F.2d at 194; *United States* v. *Friedman*, *supra*, 854 F.2d at 555-56.*

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* To the extent Newberg and Zarzecki now claim that their "fiduciary duty" request under Rule 10b-5 was also intended to apply to the wire fraud counts relating to the same conduct—a proposition belied by the record—the legal error of such an instruction in the wire fraud context is demonstrated by the very authorities they cite. *See United States* v. *Dowling*, 739 F.2d 1445, 1449 (9th Cir. 1984) ("We decline to adopt the 'fiduciary duty' limitation advanced by Dowling . . ."), *rev'd on other grounds*, 473 U.S. 207 (1985). Thus, it would not have been error to decline to charge the jury on fiduciary duties even if defendants had specifically and unambiguously requested such an instruction. *See, e.g.*, *United States* v. *Ouimette*, *supra*, 798 F.2d at 49.